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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1991

GREYSTONE III JOINT VENTURE,

Petitioner

v.

PHOENIX MUTUAL LIFE INSURANCE COMPANY,

Respondent

ON WRIT OF CERTIORARI TO THE FIFTH CIRCUIT COURT OF APPEALS

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. WHETHER THE COURT OF APPEALS ERRED IN RULING THAT THE NON-RECOURSE DEFICIENCY CLAIM COULD NOT BE CLASSIFIED SEPARATELY FROM THE TRADE CREDITOR CLASS UNDER 11 U.S.C. § 1122?

2. WHETHER THE COURT OF APPEALS ERRED IN DETERMINING THAT THE SECURITY DEPOSIT CREDITORS DID NOT HOLD CLAIMS AGAINST THE ESTATE AND COULD NOT BE COUNTED AS A SECOND IMPAIRED, ACCEPTING CLASS?

LIST OF PARTIES

1. Greystone III Joint Venture, the Petitioner in this case.

2. The members of Greystone III Joint Venture are:

Gerald D. Kucera, Managing General Partner of Greystone III Joint Venture
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Austin, TX 78731

Greystone Bank Building Partnership, Partner
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Austin, TX 78731
Gerald D. Kucera, Trustee, General Partner

Greystone III, Ltd., Partner
7200 Mopac Expwy. N., Suite 450
Austin, TX 78731
Gerald D. Kucera, General Partner
Thomas Kersig, Limited Partner
Peter Kersig, Limited Partner
Max Christen, Limited Partner
Wolfgang Hoessrich, Limited Partner
Rolf Christen, Limited Partner
Nicholas Hensel, Limited Partner

3. Phoenix Mutual Life Insurance Company, the Respondent.

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ON WRIT OF CERTIORARI TO THE FIFTH CIRCUIT COURT OF APPEALS

PETITION FOR WRIT OF CERTIORARI

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Greystone III Joint Venture, the Petitioner herein, prays that a Writ of Certiorari issue to review the judgment of the Fifth Circuit Court of Appeals entered in the above-entitled case on November 19, 1991.

OPINIONS BELOW

The Judgment of the Fifth Circuit Court of Appeals, which is herein sought to be reviewed, is reprinted in the Appendix to this Petition, page A-1. The Opinion of the Fifth Circuit Court of Appeals granting rehearing in part and denying rehearing in part is reprinted in the Appendix to this Petition, page A-3. The original opinion of the Court of Appeals is reprinted in the Appendix to this Petition, page A-6. The opinion of the Court of Appeals, as modified on rehearing, is published at 948 F.2d 134. The opinion of the United States District Court, which is reported at 127 B.R. 138, is reprinted in the Appendix, page A-42. The Order of Confirmation on Debtor's Second Amended Plan of Reorganization as Modified is reprinted in the Appendix, page A-67. The Decision on Confirma-

tion of Debtor's Second Amended Plan as Modified, which is published at 102 B.R. 560, is reprinted in the Appendix, page A-72.

JURISDICTION

The Judgment of the Fifth Circuit Court of Appeals was entered November 19, 1991. A timely Suggestion for Rehearing En Banc (which is also considered to be a petition for panel rehearing under the rules of the Fifth Circuit Court of Appeals) was filed on December 16, 1991. Panel rehearing was granted in part and denied in part on February 27, 1992. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 101(5)(A):

(5) "claim" means --

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. . .

11 U.S.C. § 1122:

Classification of claims or interests

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

11 U.S.C. § 1129(a)(10):

(a) The court shall confirm a plan only if all of the following requirements are met:

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

STATEMENT OF CASE

Greystone III Joint Venture was formed on August 30, 1983 for the purpose of developing an office

building located in Austin, Texas. The project is the Debtor's primary asset. Phoenix Mutual Life Insurance Company is the holder of a promissory note in the original principal amount of $8.8 million dated September 27, 1985. The note is secured by a deed of trust lien upon the real property and an assignment of rents. The Debtor sought protection under Chapter 11 on April 4, 1988 after Phoenix posted the property for foreclosure.

At the time of the filing the Debtor owed approximately $145,000.00 in ad valorem taxes, $9.3 million to Phoenix Mutual Life Insurance, $10,000.00 in trade debt and $20,000.00 in security deposits. The debt to Phoenix was non-recourse, sc that liability was limited to the value of the property.

On June 13, 1988, the Debtor filed its plan and disclosure statement. On September 7, 1988, the Debtor filed a First Amended Plan and Disclosure Statement. On September 28, 1988, the Debtor filed its Second Amended Plan and Disclosure Statement. Also on September 28, 1988, the

Bankruptcy Court conducted a hearing at which the Disclosure Statement was approved.

The Debtor's Second Amended Plan of Reorganization established classes for the ad valorem taxes, the secured claim of Phoenix, the non-recourse deficiency claim of Phoenix, the trade debt and the security deposits. The Plan proposed that the Debtor's partners would inject $500,000.00 in new capital to fund a Plan of Reorganization. The new capital was to be used to make payments under the Plan and to provide a reserve for capital improvements and debt service to Phoenix. The Plan provided that the ad valorem taxes would be paid in full without penalty or interest. The Plan (as modified at Confirmation) provided for restructuring the secured debt to Phoenix to provide for payments based upon a thirty (30)-year amortization at an eleven (11) percent interest rate, with a seven (7) year balloon. The Plan provided for a $200,000.00 cash payment to Phoenix in satisfaction of its deficiency claim. The Plan provided for trade creditors to receive

approximately four (4) percent of their claims (with the additional stipulation that the general partners would remain liable on the unpaid balance of these claims). The Plan also provided that the security deposit creditors would receive twenty-five (25) percent of their deposits upon Confirmation and fifty (50) percent pursuant to the terms of their leases.

On October 31, 1988, the Bankruptcy Court conducted a hearing on the propriety of the classification scheme under the Plan and the valuation of Phoenix Mutual's second claim under § 506(a) of the Code. The Court approved the classification scheme, except that the Court required that two classes of trade creditors be combined for purposes of voting. The Court valued the secured claim at $5,825.00, which included a "going concern" premium.

The trade creditors and security deposit creditors voted affirmatively to accept the Plan. The taxing authorities did not vote and were deemed to accept the Plan. Phoenix voted to reject the Plan.

After a contested Confirmation hearing on January 27, 1989, the Bankruptcy Court confirmed the Debtor's Second Amended Plan. *In re Greystone III Joint Venture*, 102 B.R. 560 (Bankr.W.D.Tex. 1989). The United States District Court affirmed the Decision of the Bankruptcy Court. *In re Greystone III Joint Venture*, 127 B.R. 138 (W.D.Tex. 1990).

On November 19, 1991, a panel of the Fifth Circuit rendered an opinion reversing the Bankruptcy Court and District Court. The panel opinion found that the Plan "impermissibly classified like creditors in different ways" when it established separate classifications for the trade debt and the non-recourse deficiency claim. The panel opinion also found that the security deposit creditors did not hold claims against the Estate and could not be counted as a second impaired, accepting class. As a result, the Court of Appeals found that the Plan had not been accepted by an impaired class of claims, as required by 11 U.S.C. § 1129(a)(10) and reversed the Confirmation Order.

The panel additionally found that the Plan violated the "absolute priority rule" contained in 11 U.S.C. § 1129(b)(2)(B). The panel concluded that the "new value" exception announced in *Case v. Los Angeles Lumber Company*, 308 U.S. 106 (1939) was repealed when Congress adopted the Bankruptcy Code.

On rehearing, the panel vacated the portion of its opinion addressing the absolute priority rule. The panel retained the portions of its opinion dealing with classification of claims and the security deposit creditors. Thus, the opinion on rehearing reversed the Order of the District Court based upon failure to obtain the assent of an impaired, accepting class as required by § 1129(a)(10).

FEDERAL QUESTION RAISED

Under 28 U.S.C. § 1334, the Courts of the United States have jurisdiction to hear all proceedings arising under Title 11. Thus, when the Debtor filed its Second Amended Plan of Reorganization on September 27, 1988, a Federal question was raised.

REASONS FOR GRANTING WRIT

This case involves the requirement that a Plan of Reorganization be accepted by at least one class of impaired creditors under 11 U.S.C. § 1129(a)(10). The District Court held that the Plan was accepted by two classes of creditors, the class of trade creditors and the class of security deposit creditors. A-48 to 53, 61 to 66, 127 B.R. at 140-41, 143-44. The Court of Appeals held that the District Court erred when it permitted the Debtor to separately classify the claims of the trade creditors from the non-recourse deficiency claim of Phoenix Mutual Life Insurance Company. A-11 to 27, 948 F.2d at 137-41. The Court of Appeals also held that the security deposit creditors did not hold claims against the estate and that their votes on the Plan of Reorganization could not be counted. A-27 to 30, 948 F.2d at 141-42.

Petitioner has designated two issues in this Petition for Writ of Certiorari. Issue One addresses the holding of the Court of Appeals that the deficiency claim could not be classed separately from

the trade creditor class. Issue Two addresses the ruling that the security deposit creditors did not hold claims which could vote upon the Plan.

A Writ of Certiorari should issue under Supreme Court Rule 10, which provides, in pertinent part:

> Rule 10. Considerations governing review on Writ of Certiorari
>
> .1. A review on Writ of Certiorari is not a matter of right, but of judicial discretion. A petition for a Writ of Certiorari will be granted only when there are special and important reasons therefore. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will considered:
>
> (a) When a United States Court of Appeals has rendered a decision in conflict with the decision of another United States Court of Ap-

peals on the same matter...

> (c) When a State Court or a United States Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this court, or has decided a federal question in a way that conflicts with applicable decisions of this court.

Review of Issue One is sought under Rule 10.1(a). The Court of Appeals held that ordinarily all unsecured claims should be classified together. This ruling conflicts with holdings by the following Courts of Appeals: *Matter of Jersey City Medical Center*, 817 F.2d 1055 (3rd Cir. 1987); *Teamsters National Freight Industry Negotiating Committee v. U.S. Truck Company, Inc.*, 800 F.2d 581 (6th Cir. 1986); *Hansen v. First Bank of South Dakota*, 822 F.2d 1310 (8th Cir. 1987); *Olympia & York Florida Equity Corp. v. Bank of New York*, 913 F.2d 873 (11th Circuit 1990); *Barnes v. Whelan*, 689 F.2d 193 (D.C. Cir. 1982). The ruling of the Court of

Appeals is consistent with the following Circuits: *Granada Wines Inc. v. New England Teamsters and Trucking Industry Pension Fund*, 748 F.2d 42 (1st Cir. 1984); *Travelers Insurance Company v. Bryson Properties, XVIII*, ____ F.2d____, 1992 WL 77524 (4th Cir. 1992).

Review of the Issue Two is sought under Rule 10.1(c). The Fifth Circuit is the first Court of Appeals to address the issue of whether parties to leases who have given security deposits are creditors whose votes may be counted in balloting upon a Plan of Reorganization. The issue is important in the context of this case because it is not necessary to reach Issue One if the security deposit creditors are counted as an impaired, accepting class.

ISSUE ONE

> Whether the Court of Appeals erred in ruling that the non-recourse deficiency claim could not be classified separately from the trade creditor class under 11 U.S.C. § 1122?

The Fifth Circuit ruled that the Debtor was

prohibited from separately classifying the non-recourse deficiency claim held by Phoenix from the trade creditor claims. In reaching this determination, the Fifth Circuit adopted a restrictive view of classification under §1122 and an expansive view of the voting rights of an undersecured creditor. Specifically, the Fifth Circuit held that "ordinarily 'substantially similar claims,' those which share common priority and rights against the Debtor's estate, should be placed in the same class." A-17, 948 F.2d at 139. The Fifth Circuit also held that "thou shalt not classify similar claims differently in order to gerrymander in an affirmative vote on a reorganization plan." Id. In this section, Petitioner will show that the Fifth Circuit placed limitations upon the classification power under §1122 which cannot be justified based upon a plan reading of the statute. The Fifth Circuit also adopted a position which greatly expanded the voting rights of an undersecured creditor beyond those provided in the Code.

A. Section 1122 and Congressional Intent.

This case involves construction of a statute, 11 U.S.C. §1122. The Court of Appeals construed §1122 as limiting the Debtor's discretion to classify claims. The Court of Appeals reached this result both as a matter of statutory construction and in furtherance of its view of the policies behind §1122.

Statutory interpretation begins with the language of the statute itself. *Pennsylvania Department of Public Welfare vs. Davenport*, 495 U.S. 552, 109 L.Ed. 2d; 588, 110 S.Ct. 2126 (1990). The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 103 L.Ed.2d 290, 109 S.Ct. 1026 (1989).

Classification is governed by 11 U.S.C. §1122. Under §1122, a Debtor may not place dissimilar claims in the same class. However, the Debtor is not required to place all similar claims in the same class.

> The express language of (§1122) explicitly forbids a plan from placing dissimilar claims in the same class; it does not though address the presence of similar claims in different classes. Although the legislative history behind §1122 is inconclusive regarding the significance (if any) of this omission, it remains clear that Congress intended to afford bankruptcy judges broad discretion to decide the propriety of plans in light of the facts of each case (citation omitted).
>
> Accordingly we agree with the general view that permits the grouping of similar claims in different classes.

Matter of Jersey City Medical Center, at 1060-61 (3rd Cir. 1987); *Barnes v. Whelan*, at 201. The Sixth, Eighth and Eleventh Circuits also allow multiple classes of unsecured creditors. *Teamsters National Freight Industry Negotiating Committee v. U. S. Truck Co., Inc.*; *Hansen v. First Bank of South*

Dakota; *Olympia & York Florida Equity Corp. v. Bank of New York*.

The Fifth Circuit, however, took a more restrictive reading of the statute. The Court of Appeals stated:

> We observe from this language that the lower court's suggestion that §1122 does not prevent classification of like claims in separate classes is oversimplified. It is true that §1122(a) in terms only governs permissible inclusions of claims in a class rather (than) requiring that all similar claims be grouped together. One cannot conclude categorically that §1122(a) prohibits the formation of different classes from similar types of claims. But if §1122(a) is wholly permissive regarding the creation of such classes, there would be no need for §1122(b) specifically to authorize a class of smaller unsecured claims, a common

> feature of plans and reorganization cases past and present. The broad interpretation of §1122(a) adopted by the lower courts would render §1122(b) superfluous, a result that is anathema to elementary principles of statutory construction.
>
> §1122 consequently must contemplate some limits on classification of claims of similar priority. A fair reading of both subsections suggest that ordinarily "substantially similar claims," those which share common priority in rights against the Debtor's estate, should be placed in the same class.

A-15 to 17, 948 F.2d at 138-39.

The Fifth Circuit's conclusion that §1122(b) necessarily implies a restriction upon the Debtor's classification powers relies on a forced reading of Congressional intent. Section 1122(b) is merely an example of a permissible classification. By giving an example, Congress did not imply that other

classifications were improper. Additionally, in adopting §1122(b), Congress wished to codify the pre-code practice with respect to administrative convenience claims. S. Rep. No. 989, 95th Cong., Sec. Sess. 118 (1978), reprinted at 1978 U.S. Code Cong. Admin. News, 5787, 5904. The pre-code practice involved paying small claims in cash in full for reasons of administrative convenience. This involved both separate classification and preferential treatment over larger unsecured claims which might be paid out over time and which might not receive payment in full. *Brockett v. Winkle Terra Cotta Company*, 81 F.2d 949 (8th Cir. 1936) (approving discrimination in favor of small unsecured claims); *In re New Rochelle Coal & Lumber Company*, 77 F.2d 881 (2nd Cir. 1935) (approving plan in which small unsecured claims were paid in full while other unsecured claims were paid over time); *In re Realty Associates Securities Corporation*, 53 F. Supp. 1010 (E.D. New York 1943) (discrimination in favor of small unsecured claims permitted). Thus, the authorization for

administrative convenience classes related to more than just classification.

The Fifth Circuit's "fair reading" of §1122 is also strained. The Court of Appeals concluded that because §1122 prohibits classifying dissimilar claims together that it also requires similar claims to be classified together. While the Fifth Circuit did not make this an absolute requirement, stating that it would apply "ordinarily," it did not state any circumstances in which exceptions to the ordinary rule would be permitted. Thus, the Fifth Circuit's rule has the effect of a conclusive presumption.

The Fifth Circuit's presumption suffers from two major deficiencies. The first is that it has no basis in the plain language of the statutes governing classification. §1123(a)(1) permits a Debtor, to establish classes of claims subject to § 1122. Section 1122 prohibits classifying dissimilar claims together and permits administrative convenience classes. The plain statutory text supports no other restriction. It is a fallacy of logic and statutory

interpretation to insist that because classification of dissimilar claims together is prohibited that classification of similar claims together is required.

The Fifth Circuit's interpretation is also flawed based upon the history of the statute. Under the Bankruptcy Act, classification was governed by 11 U.S.C. § 597 (from former Chapter X) and § 751 (from former Chapter XI). § 597 expressly required that classification be established "according to the nature of their respective claims and stock." § 751, on the other hand, merely stated that "for the purposes of the arrangement and its acceptance, the court may fix the division of creditors into classes..." When Congress adopted § 1122, the language it chose was less restrictive than that contained in § 597. "Congress' switch to less restrictive language in § 1122 of the Code seems to warrant a conclusion that Congress no longer intended to impose the now omitted requirement that similar claims be classified together." *U.S. Truck Company, Inc.*, at 585.

The Fifth Circuit's analysis also appears to be

colored by its view of the policies behind the classification statute. In its opinion, the Fifth Circuit stated:

> Chapter 11 requires classification of claims against a Debtor for two reasons. Each class of creditors will be treated in the Debtor's Plan of Reorganization based upon the similarity of its member's priority status and other legal rights against the Debtor's assets. 11 U.S.C. §1122. Proper classification is essential to ensure that creditors with claims of similar priority against the Debtor's assets are treated similarly. Second, the classes must separately vote whether to approve a Debtor's Plan of Reorganization... Classification of claims thus affects the integrity of the voting process, for, if claims could be arbitrarily placed in separate classes, it would almost always be possible for the Debtor to

manipulate "acceptance" by artful classification.

A-11 to 12, 948 F.2d at 137-38.

This analysis places too much importance upon the role of classification in a Plan of Reorganization. Section 1122 is not the guardian of similar treatment among similar claims. § 1129(b)(1) prohibits unfair discrimination in a plan. The legislative history to this section indicates that a plan may not be confirmed unless "the class is not unfairly discriminated against with respect to equal classes." H.R.Rep.No. 95-595, p.416, reprinted at 1978 U.S.Code Cong.& Admin. News 5787, 6372. Because secured claims are unique and must be classified separately, *In re Commercial Western Finance Corporation*, 761 F.2d 1329 (9th Cir. 1985), the reference to "equal classes" apparently refers to multiple classes of unsecured claims. Thus, § 1129(b)(1) was intended to prevent discriminatory treatment among multiple classes of unsecured claims.

Additionally, it is far fetched to suggest that

artful classification can be used to obtain the acceptance of all classes as required by § 1129(a)(8). Creation of multiple classes of unsecured claims makes it more likely that a dissenting creditor will dominate its class and prevent acceptance by all classes.

The structure of Title 11 also suggests that § 1122 does not have the major substantive role envisioned for it by the Fifth Circuit. Sections 1121 through 1128 of the Code set forth the mechanics by which a plan of reorganization may be proposed, what it may contain, how acceptances may be solicited, the majority for determining acceptance and how a plan may be modified. However, the substantive requirements for confirmation of a plan are contained within §1129. Because § 1122 is found within the procedural sections of Title 11, it is reasonable to conclude that it does not play a major substantive role under the Code.

A fair reading of Sections 1122 and 1123 establishes only that Congress authorized creation of classes of claims, that dissimilar claims may not be

classified together and that administrative convenience classes are expressly permitted. Congress could easily have drafted a requirement that similar claims be classified together, but did not. The restrictive view adopted by the Fifth Circuit is not supported by the language, the structure or the history of the Code. Therefore, the Fifth Circuit erred when it ruled that "ordinarily 'substantially similar claims,' should be placed in the same class."

B. Gerrymandering and Voting Under the Code.

11 U.S.C. § 1129(a)(10) requires that a plan be accepted by at least one class of impaired claims in order to be confirmed. In rejecting the Debtor's classification system, the Fifth Circuit relied upon the maxim that "thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan." A-17, 948 F.2d at 139. The Fifth Circuit also stated that, "We conclude that if §1122(a) permits classification of 'substantially similar' claims in different classes,

such classification may only be undertaken for reasons independent of the Debtor's motivation to secure the vote of an impaired, assenting class of claims." A-19 to 20, 948 F.2d at 139. The Fifth Circuit found that the Debtor's classification scheme did not satisfy this test.

The gerrymandering concept arises from a mistaken view of the role of voting under the Bankruptcy Code. The Code does not grant blocking power to large unsecured claims. The Fifth Circuit's gerrymandering analysis is further colored by its erroneous view of the requirements of classification under §1122. Gerrymandering is a concept which has no firm footing under the Bankruptcy Code and which does not provide a principled test for determining classification under the Bankruptcy Code.

Among the Circuit Courts, the gerrymandering concept had its origin in the Sixth Circuit's opinion in *U.S. Truck Company, Inc.* In that case, the Debtor classified the claim of the Teamsters separately from the claims of the trade creditors. This

was done for the express purpose of obtaining an impaired, accepting class. 800 F.2d at 586, n.8. The Sixth Circuit noted that the Code did not prohibit separate classification of similar creditors but expressed concern that "there must be some limit on a Debtor's power to classify creditors in such a manner." 800 F.2d at 586. It was not necessary for the Sixth Circuit to determine what that limit might be because it found that the Teamsters had a "virtually unique interest." 800 F.2d at 587. The Sixth Circuit also found that the Teamsters had "a different stake in the future viability of the reorganized company," so that the Teamsters had different motivations for voting. *Id.* Thus, the Sixth Circuit allowed the separate classification even though it was intended to satisfy the requirement of § 1129(a)(10).

In this case, the Sixth Circuit's dicta that there must be "some limit" on the classification power was combined with the Fifth Circuit's ruling that unsecured claims should be classified together to produce a ruling which required that separate

classifications for unsecured claims be denied where the Court determines that the Debtor's subjective intent was to obtain an impaired, accepting class under §1129(a)(10). Ironically, although the Fifth Circuit based its ruling upon the *U.S. Truck* dicta, the classification in that case probably would not have survived the *Greystone* test. In *U.S. Truck*, the Debtor separately classified unsecured creditors for the purpose of obtaining an impaired, accepting class -- a practice banned by *Greystone*.

The gerrymandering test appears to overlook prior Fifth Circuit precedent on a related matter. In *Matter of Sun Country Development, Inc.*, 764 F.2d 406 (5th Cir. 1985), the Court held that it was permissible for a Debtor to use the impairment power in order to meet the requirements of §1129(a)(10). In that case, the Debtor's initial plan provided for two small unsecured creditors to be left unimpaired and paid in full at confirmation. When the secured creditor in the case failed to accept the plan, the Debtor impaired the unse-

cured creditors by providing for payments sixty days after confirmation. The Fifth Circuit affirmed confirmation, stating, "Congress made the cram-down available the Debtor; use of it to carry out a reorganization cannot be bad faith." *Id.* at 408.

Sun Country stands for the proposition that a Debtor may use the tools available to it under the Bankruptcy Code to obtain confirmation of a plan. In this case, the Court of Appeals should have allowed the Debtor to use the classification power to obtain confirmation of a plan of reorganization. This is particularly so because the gerrymandering limitation serves no bankruptcy purpose.

In the political realm, gerrymandering is condemned because it undermines the principle of one person, one vote. *Davis v. Bandemer*, 478 U.S. 109, 106 S.Ct. 2797, 92 L.Ed. 2d 85 (1986). However, voting under the Bankruptcy Code is not based upon a principle of one dollar, one vote. If this were the case, the largest creditor in a case (or the creditors holding a majority of claims) could veto a plan. Instead, a plan may be confirmed over

the objection of the largest creditors, so long as there is at least one class of impaired, accepting claims and the plan meets the requirements for cram-down under § 1129(b). There are several situations in which a plan may be legitimately confirmed with the support of only a few creditors and over the objection of a large creditor. For example, if a plan is opposed by a large fully secured creditor and supported by a small dollar amount of trade creditors, the plan may be confirmed over the objection of the large secured creditor. Additionally, if a plan is supported by a small secured creditor, it may be confirmed over the objection of all other secured and unsecured creditors, provided that the requirements for cram-down are satisfied.

Voting on a plan is not based upon the principle that the creditor with the most votes wins. Instead, voting is used to determine the applicable standard for confirmation of the plan. If all classes of claims vote in favor of a plan, the plan can be confirmed if it meets the requirements of § 1129(a).

In re American Solar King Corp., 90 B.R. 808 (Bankr.W.D.Tex. 1988). If a plan is approved by at least one but not all classes of impaired creditors, the plan may be confirmed only if it satisfies the requirements of both §1129(a) and §1129(b). *In re Greystone III Joint Venture*, 102 B.R. 560 (Bankr.W.D. Tex. 1989), *rev'd*, 948 F.2d 134 (5th Cir. 1991). Finally, if a plan is not accepted by any class of creditors, it may not be confirmed no matter how salutary or equitable it may be. *In re Anderson Oaks (Phase I) Limited Partnership*, 77 B.R. 108 (Bankr.W.D.Tex. 1987).

The statutory language does not support the Fifth Circuit's conclusion that the Debtor's plan deprived Phoenix of its voting rights. §1129(a)(10) merely requires that the plan be accepted by an impaired class of claims. It does not specify how large that class must be.

The so-called gerrymandering in this case did not deprive Phoenix of its right to vote. Phoenix controlled two classes of claims, one secured and one unsecured. Both of these classes of claims

voted to reject the plan. By voting no, Phoenix prevented the Debtor from satisfying the requirements of § 1129(a)(8) (acceptance by all classes) and required the Debtor to proceed to cram-down. The Debtor was required to satisfy the requirements of §1129(b) with respect to both secured and unsecured creditors. These were the voting rights to which Phoenix was entitled.

The history of § 1129(a)(10) demonstrates that it was intended to remedy a narrow problem. During consideration of the Bankruptcy Code, two Chapter XII cases were decided which allowed confirmation without the support of any creditors. *Matter of Marietta Cobb Apartments*, 3 B.C.D. 720 (Bankr.S.D.N.Y. 1977); *Matter of Hobson Pike Associates, Ltd.*, 3 B.C.D. 1205 (Bankr.N.D.Ga. 1976).

In an apparent response to these cases, Senate Bill 2266 required that at least one class of creditors, exclusive of insiders, accept the plan. The legislative history to this provision stated only that "Paragraph (12) requires at least one class must

accept the plan, but any claims or interests held by insiders are not to be included for purposes of determining the number and amount of acceptances." S. Rep. No. 95-989, p. 128, reprinted at 1978 U.S. Code Cong. and Admin. News 5787, 5914. At its inception, the statutory provision required only that the plan be accepted by some class of claims. Because the Senate Bill contained the flexible classification provision which was adopted as § 1122, the Senate Bill did not contemplate that a plan be accepted by all unsecured creditors. Additionally, the Senate Bill did not contain a cram-down provision. Thus, § 1129(a)(10) was not proposed for any purpose related to cram-down.

When the House and Senate floor managers met, they included the flexible classification provision which was included in both the House and Senate Bills, the Senate's requirement of an impaired accepting class and the House provisions for cram-down. A-90 to 91, 102 B.R. at 564-66.

The new §1129(a)(10) received little mention by

the floor managers of the Bill. It was stated only that "§1129(a)(10) is derived from §1130(a)(12) of the Senate Amendment." 124 Cong. Rec. S17420, 95th Cong., Sec. Session (Daily Ed. October 6, 1978) (remarks of Senator DeConcini), reprinted in 1978 U.S. Code Cong. and Admin. News 5787, 6473. §1129(a)(10) was not given any particular significance in connection with cram-down. In discussing the cram-down provisions, the floor managers stated:

> §1129(b) is new. Together with §1111(b) and §1129(a)(7)C, this section provides when a plan may be confirmed, notwithstanding the failure of an impaired class to accept the plan under §1129(a)(8).

Id. at 1978 U.S. Code Cong. and Admin. News 6474.

Thus, §1129(a)(10) was conceived as a technical amendment to require that a plan be accepted by at least some creditors. It did not require

acceptance by the largest creditor in a case and did not grant veto power to such creditors. *In re Triple R Holdings, L.P.*, 134 B.R. 382, 387-89 (Bankr.N.D.Ca. 1991). Because no veto was contemplated, multiple classes of claims do not dilute a creditors voting rights and no restriction on gerrymandering is necessary or proper.

C. The Classification was Proper.

The Bankruptcy Court reviewed the Debtor's classification scheme at a separate hearing for that purpose (See Fed.R.Bankr.Pro.3013). After careful consideration of the Debtor's grounds, the Court approved the classification scheme. Congress intended the Bankruptcy Courts to have "broad discretion to determine proper classification according to the factual circumstances of each case." *U.S. Truck*, at 586. Thus, the Court of Appeals should have affirmed the classification ruling unless it was clearly erroneous. *Hansen v. First Bank of South Dakota*, at 1312.

Even if there must be "some limit" on the Debtor's classification power, the strict test applied by the

Fifth Circuit is not required. Other Courts -- including Fifth Circuit precedent under the Bankruptcy Act -- have applied a rational basis test. A rational basis test more faithfully reflects the flexible classification scheme allowed by § 1122. In *Matter of Jersey Medical Center*, the Third Circuit stated "that the classification of the claims or interests must be reasonable." In a prior decision under the Bankruptcy Act, the Fifth Circuit stated:

> As a general rule, the classification in a plan should not do substantial violence to any claimant's interest. The plan should not arbitrarily classify or discriminate against creditors (citations omitted). The fact that Bankruptcy Courts are courts of equity, however, allows exceptions to any strict rules of classification of claims.

Matter of LeBlanc, 622 F.2d 872, 879 (5th Cir. 1980).

These cases furnish the proper standard for reviewing the classification in this case. The classi-

fication in this case did not do substantial violence to any claimant's interest; the classification was not arbitrary and the classification was not used to discriminate against creditors. The trade creditors and deficiency creditor held claims of differing legal and factual natures, with differing incentives to vote.

The Fifth Circuit held that the claims of the trade creditors and deficiency creditors were of the same legal nature. The Court stated that because §1111(b) grants the non-recourse deficiency claim a "recourse" claim for purposes of the Chapter 11 bankruptcy, that there was no difference between the Code created deficiency claim and the trade creditor claims. A-20, 948 F.2d at 139-40. However, this does not erase the distinction between the claims. Several courts have recognized the propriety of separately classifying non-recourse deficiency claims from those of trade creditors. *In re Bjolmes Realty Trust*, 134 B.R. 1000 (Bankr.D.Mass. 1991); *In re 222 Liberty Associates*, 108 B.R. 971 (Bankr.E.D.Pa. 1990); *In re Aztec*

Company, 107 B.R. 585 (Bankr.M.D.Tenn. 1989).

The trade creditors enjoy recourse against the Debtor's general partners under state law. The code created deficiency claim does not enjoy this privilege. The Debtor classified the claim separately for the purpose of recognizing that the general partners would remain liable on the trade creditor claims. The District of Columbia Circuit has allowed separate classification based upon third party liability in *Barnes v. Whelan.*

The claims were also factually separate. The trade creditors furnished goods and services with a reasonable expectation of being paid on a prompt basis. On the other hand, the deficiency creditor intentionally entered into a long-term lending relationship on a secured basis. Several cases recognize the propriety of separate classifications for trade creditors. *Matter of Jersey Medical Center,* ("We immediately note the reasonableness of distinguishing the claims of physicians, medical malpractice victims, employee benefit plan participants and trade creditors"); *Matter of LeBlanc,*

("The trade creditors advanced goods and services to the Debtor in the ordinary course of business, frequently without any knowledge of the Debtor's financial perilous condition and without any real opportunity to protect themselves"); *In re Ag Consultants Grain Division, Inc.*, 77 B.R. 665 (Bankr.N.D.Ind. 1987) (separate classification of trade creditors doing business with the Debtor from trade creditors not continuing to do business); *Matter of Rochem Ltd.*, 58 B.R. 641 (Bankr.D.N.J. 1985) (separation of tort claimants from trade creditors approved).

Separate classification is also justified by the different motivation which each class had for voting upon the plan. The Sixth Circuit allowed separate classification where the dissenting creditor "has a different stake in the future viability of the reorganized Debtor..." *U.S. Truck Company, Inc.*, at 587. In this case, Phoenix had a different stake in the Debtor's continued viability. The trade creditors, as pure unsecured creditors, had an incentive to work with the Debtor to obtain pay-

ment of their claims and to continue to do business with the reorganized Debtor. On the other hand, Phoenix indicated by its actions that it was voting its unsecured claim for the purpose of putting the Debtor out of business. This would not benefit the unsecured claim held by Phoenix. Indeed, if Phoenix is successful in foreclosing upon the property, the deficiency portion of the claim will be erased as a matter of law. Phoenix voted its deficiency claim, not as an unsecured claim, but for the purpose of benefiting its secured claim. In a similar circumstance, one Bankruptcy Judge recently stated:

> The FDIC's mortgage interest greatly influences the manner in which it will vote its unsecured claim. This became obvious at the hearing when the FDIC indicated that it would vote its claim against the plan in order to strengthen its case for terminating the automatic stay now preventing it from foreclosing on the building. Holders of trade

> claims would receive nothing from the foreclosure and little if anything from liquidation of the Debtor's other assets, consisting primarily of equipment. Thus, they would likely vote in favor of the plan. . .
>
> . . . In light of the heavy linkage in law and fact between the FDIC's secured and unsecured claims, its unsecured claim is that in name only. No policy concerns require that it dilute, here dominate, the vote of those truly acting in their interests as trade creditors.

In re Bjolmes Realty Trust, at 1003-04; *In re Creekside Landing, Ltd.*, ___ B.R.____, 1992 WL 100431 (Bankr.M.D.Tenn. 1992).

Debtor's classification was proper. It recognized the factual and legal distinctions between the claims. It allowed for the Debtor to expressly provide for the general partners to remain liable on the trade debt. It recognized the differing stake that the two classes had in the Debtor's continued

viability. The classification was reasonable and was not arbitrary. The Bankruptcy Court's ruling was not clearly erroneous. Therefore, it should have been approved.

ISSUE TWO

> Whether the Court of Appeals erred in determining that the security deposit creditors did not hold claims against the estate and could not be counted as a second impaired accepting class?

The United States District Court held that the claims of the security deposit creditors constituted a second impaired accepting class of the Debtor's plan. A-61 to 66, 127 B.R. at 143-44. The Court of Appeals rejected this contention. The Court of Appeals ruled that only a party to a lease which is rejected holds a provable claim against the estate. Because the Debtor did not reject the leases with its tenants, the Fifth Circuit held that the security deposit creditors were not entitled to vote upon the plan of reorganization and thus were not entitled to

be counted as an impaired, accepting class.

The Fifth Circuit's analysis fails to distinguish between the obligations with respect to the security deposits, which were a debt, and the executory portion of the leases. The Debtor's obligation to perform for the remaining balance of the lease (that is, the obligation to supply leased premises) is properly analyzed as an obligation under an executory contract. However, the security deposit represents a contingent debt. 11 U.S.C. §101(5)(A) defines claim as "a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured..." A security deposit is a contingent, unmatured right to payment. The Code defines creditor as "entity that has a claim against the Debtor that arose at the time of or before the order for relief concerning the Debtor." Because the security deposit was posted prior to the order for relief, the party entitled to a refund of the security deposit is a creditor under §101(10)(A).

Creditor deposits were allowed to vote as an impaired, accepting class in the case of *In re Temple Zion*, 125 B.R. 910 (Bankr.E.D.Pa. 1991). Parties to executory contracts were allowed to vote in *Confederation Life Insurance Company v. Beau Rivage, Ltd.*, 126 B.R. 632 (N.D.Ga. 1991).

Much of the authority relied upon by the Court of Appeals in its opinion is of little help in analyzing this issue. *In re Cochise College Park, Inc.*, 703 F.2d 1339 (9th Cir. 1983) is a decision under the Bankruptcy Act which speaks in terms of "provability" of a claim. The concept of provability was abandoned when the Bankruptcy Code was adopted. *In re Perdido Motel Group Inc.*, 101 B.R. 289 (Bankr.N.D. Ala. 1989) and *In re Distrigas Corp.*, 66 B.R. 382 (Bankr.D.Mass. 1986) deal with priority tax claims and have little relevance to pre-petition security deposits. *LJC Corp. v. Boyle*, 768 F.2d 1489 (D.C. Cir. 1985) holds that a tenant's obligation to pay rent under an assumed lease is an administrative claim. However, *LJC Corp.* involved

the Debtor's obligation to pay rent. In order to assume a lease, it is necessary for the Debtor to pay all amounts owing. However, in the case of a Debtor/Landlord holding security deposits, the obligation to make payment has not yet arisen.

Analytically, the security deposits may be treated as a debt with a maturity in the future. If the Debtor acquires an off-set to this claim prior to its maturity, the Debtor may not be required to make payment. However, until the Debtor acquires an off-set, it remains liable for the deposit. In this respect, the liability for the security deposit is like other debts which may be restructured under and which may form impaired classes of claims under the Bankruptcy Code.

CONCLUSION

The Court of Appeals erred in reversing the Order of the District Court. The Debtor's Plan of Reorganization was accepted by two impaired classes of creditors. The Debtor should have been permitted to separately classify the non-recourse deficiency claim from the trade creditor claims.

The restriction relied upon by the Court of Appeals cannot be justified either in the language of the statute or the legislative history. There is no basis for the conclusion that Congress intended all unsecured claims to be classified together. Additionally, the "gerrymandering" test relied upon by the Court of Appeals does not furnish a principled basis for distinguishing among classifications of claims.

The security deposit creditors furnished a second class of impaired accepting claims. The claims relating to the security deposits arose pre-petition and are defined as claims under the Bankruptcy Code. The deposit portion of the claim, as opposed to any claims for post-petition breach, furnishes a proper example of a pre-petition claim against the Estate which may be modified in a Plan of Reorganization.

Because the Court of Appeals erred in determining that the Debtor's Plan was not accepted by an impaired class of claims, the Judgment of the Court of Appeals should be reversed and the Order

of the District Court reinstated.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Adrian M. Overstreet, a member of the Bar of the Supreme Court of the United States and counsel of record for Greystone III Joint Venture, Petitioner, herein, hereby certify that on May 26, 1992, pursuant to Rule 33, Rules of the Supreme Court, I served three copies of the foregoing Petition for Writ Certiorari on each of the parties herein as follows:

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All parties required to be served have been served.

DATED:_____

Original Signed by
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_____
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